



DEPARTMENT OF HOMELAND SECURITY
Office of Inspector General
Oakland Field Office – Audits Division
1111 Broadway, Suite 1200
Oakland, California 94607-4052

April 15, 2003

MEMORANDUM

TO: Jeff Griffin, Regional Director, Region IX

Robert J. Lastrico

FROM: Robert J. Lastrico, Field Office Manager

SUBJECT: Performance Audit Report: Management of FEMA
Disaster Grants Awarded Under the Stafford Act
State of Arizona, Arizona Division of Emergency Management
Audit Report Number DO-03-03

This memorandum transmits the results of the subject audit performed by Cotton & Company LLP, an independent public accounting firm. In summary, the audit determined that the State of Arizona, Arizona Division of Emergency Management (ADEM) could improve certain program procedures associated with the administration of disaster assistance funds. On March 21, 2003, you responded to the draft report (Exhibit B of the attached report). However, in order to resolve and close the 15 findings and associated recommendations in the report, we require additional actions or information from you or ADEM on 12 of the findings as identified in the following table:

Finding Number	Finding Title	Additional Actions Required
A.2.	ADEM did not have clear procedures to ensure that IFG program plans were submitted annually.	Provide a copy of the current approved IHP SAP for the period October 15, 2002 through December 31, 2003.
A.3.	ADEM exceeded IFG program completion deadlines for grant and administrative activity.	Provide copies of ADEM's requests for time extensions and Regional guidance to ADEM or ADEM's revised procedures to complete IFG closeout packages in a timely manner.

Finding Number	Finding Title	Additional Actions Required
A.4.	ADEM did not submit Section 409 HM plans as required for each disaster.	Provide copy of procedures established to ensure Section 409 HM plans are submitted in a timely manner and documentation is maintained to support plan submission.
A.5.	ADEM did not submit required quarterly progress reports for three sampled HM projects.	Provide documentation that the system instituted to submit quarterly progress reports has been implemented.
A.6.	ADEM did not obtain documentation to support the required benefit-cost analysis (BCA) of a project or obtain documentation to show that a house was substantially damaged at the time of project approval.	Provide 1) documentation requiring ADEM to strengthen policies and procedures regarding BCAs or substantially damaged certifications, and 2) ADEM's policies or procedures to implement this requirement.
A.7.	ADEM did not require buy-out project applicants to sign agreements with the Regional Director stating that restrictive covenants will be included in all buy-out deeds.	Provide correspondence to ADEM requiring that buy-out applicants sign agreements with the Regional Director regarding restrictive covenants.
A.9.	ADEM did not have documentation or internal control procedures to ensure the cost allowability of all HM subgrantee payments.	Provide 1) support for in-kind costs of \$1,814 on Project No. 1304-1 or documentation that \$5,442 was deobligated and 2) review results of Project No. 1347-2 and any necessary deobligation documents for costs that were not adequately supported.
B.10.	ADEM did not adequately support claimed IFG administrative costs.	Provide results of the region's evaluation of ADEM's supporting documentation for project cost claims of \$3,723 and \$26,861 on Disaster Nos. 1304 and 1347, respectively.
B.11.	ADEM did not segregate IFG administrative and PA management grant costs.	Provide documentation that ADEM 1) will either break up subtotals in journal entries by program or 2) has chosen the option in which FEMA administers and processes ONA, which replaces IFG.

Finding Number	Finding Title	Additional Actions Required
B.12.	ADEM did not have adequate cash management procedures over IFG projects.	Provide results of the region's and ADEM's efforts on cash monitoring and collections, enabling prompt return of excess federal advances.
B.13.	ADEM did not submit FCTRs to FEMA.	Provide copy of procedures established to ensure FCTRs are submitted to FEMA within 15 working days after the end of each quarter.
B.14.	ADEM did not accurately report total program outlay on FSRs.	Provide copies of current FSRs containing the note that the recipient share of amounts reported does not include the local cost-share match met by subgrantees.

Pursuant to FEMA Instruction 1270.1, by June 16, 2003, please provide the documentation or information requested above or provide us a date as to when such information will be provided.

We would like to thank your staff and ADEM's staff for the courtesies extended the auditors during their fieldwork. Should you have any questions concerning this report, please contact Brian Byrne or me at (510) 627-7011.

April 19, 2003

Federal Emergency Management Agency
Office of Inspector General
Washington, DC

In accordance with the terms of our July 16, 2001, contract, Cotton & Company LLP audited the grant management process used by the State of Arizona, Department of Emergency and Military Affairs, Division of Emergency Management (ADEM), for two disaster awards by the Federal Emergency Management Agency (FEMA) under the Stafford Act.

The primary audit objectives were to determine if ADEM administered FEMA disaster grant programs according to federal regulations, properly accounted for and used FEMA program funds, and submitted accurate financial expenditure reports. Our audit scope did not include interviews with ADEM subgrantees or technical evaluation of the work performed. We identified several program management findings primarily related to the Hazard Mitigation and Individual and Family Grant programs, as well as financial management issues primarily related to cash management and Individual and Family Grant administrative costs. We also identified FEMA-wide issues that are addressed in a separate letter to the Office of the Inspector General.

We conducted the audit in accordance with *Government Auditing Standards*, as revised. We were not engaged to, and did not perform a financial statement audit, the purpose of which would be to express an opinion on the specified elements, accounts, or items. The audit included the applicable Public Assistance, Hazard Mitigation, and Individual and Family Grant programs awarded under each disaster.

We understand that this audit was requested for the purpose of determining if ADEM administered FEMA disaster grant programs according to federal regulations, properly accounted for and used FEMA program funds, and submitted accurate financial expenditure reports. This report is intended to meet these objectives and should not be used for other purposes.

Please contact me at (703) 836-6701 if you have questions.

Very truly yours,

COTTON & COMPANY LLP

By: _____
Sam Hadley, CPA, CGFM

Table of Contents

I. Executive Summary	1
II. Introduction	2
III. Objectives, Scope, and Methodology	3
IV. Findings and Recommendations	5
A. Program Management	5
1. ADEM's administrative plans referred to outdated legislation.	5
2. ADEM did not have clear procedures to ensure that IFG program plans were submitted annually.	6
3. ADEM exceeded IFG program completion deadlines for grant and administrative activity.	7
4. ADEM did not submit Section 409 HM plans as required for each disaster.	8
5. ADEM did not submit required quarterly progress reports for three sampled HM projects.	9
6. ADEM did not obtain documentation to support the required benefit-cost analysis of a project or obtain documentation to show that a house was substantially damaged at the time of project approval.	10
7. ADEM did not require buy-out project applicants to sign agreements with the Regional Director stating that restrictive covenants will be included in all buy-out deeds.	11
8. ADEM did not have procedures to assure proper controls over an advance given to one HM subgrantee.	12
9. ADEM did not have documentation or internal control procedures to ensure cost allowability of all HM subgrantee payments.	13
B. Financial Management	14
10. ADEM did not adequately support claimed IFG administrative costs.	14
11. ADEM did not segregate IFG administrative and PA management grant costs.	15
12. ADEM did not have adequate cash management procedures over IFG disasters.	16
13. ADEM did not submit FCTRs to FEMA.	17

14. ADEM did not accurately report total program outlays on FSRs.	18
15. ADEM did not review a subgrantee's cost-share expenses throughout the HM project.	19

V. ATTACHMENTS

- A. Independent Accountants' Report on Application of Agreed-Upon Procedures, State of Arizona, Department of Emergency and Military Affairs, Division of Emergency Management, Schedules of Sources and Applications of Funds
 - A-1. Schedule of Sources and Applications of Funds Under Disaster No. 1304
 - A-2. Schedule of Sources and Applications of Funds Under Disaster No. 1347
- B. Schedule of Questioned Costs
- C. Combined comments from State of Arizona, Department of Emergency and Military Affairs, Division of Emergency Management and FEMA Regional Office

Auditors' Note: Combined comments included in Attachment C above, do not include the referenced attachment, 'Audit response from the Arizona Department of Emergency Management' due to the size of the attachment.

I. EXECUTIVE SUMMARY

Cotton & Company LLP completed an audit of the administration of disaster assistance grant programs by the State of Arizona, Department of Emergency and Military Affairs, Division of Emergency Management (ADEM). The objectives of this audit were to determine if ADEM administered Federal Emergency Management Agency (FEMA) disaster grant programs according to federal regulations, properly accounted for and used FEMA program funds, and submitted accurate financial expenditure reports. This report focuses on ADEM's systems and procedures for assuring that grant funds are managed, controlled, and expended in accordance with applicable laws and regulations, including the Robert T. Stafford Disaster Relief and Emergency Act and Title 44 of the *Code of Federal Regulations* (CFR).

We audited two major disasters declared by the President of the United States between October 1999 and October 2000 (Disaster Nos. 1304 and 1347). Disaster No. 1304 involved the Individual and Family (IFG) and Hazard Mitigation (HM) programs. Disaster No. 1347 involved the Public Assistance (PA), IFG, and HM programs. The federal share of total obligations for these two disasters was \$6,931,188, and expenditures through September 30, 2001, were \$4,587,713. We reviewed expenditures and financial reporting through September 30, 2001.

We did not perform a financial audit of these costs. Accordingly, we do not express an opinion on costs claimed by ADEM (Attachments A-1 and A-2 to this report). During our audit, we identified questioned costs (Attachment B). We did not perform statistical sampling, and therefore did not project questioned costs to the full population of claimed costs.

Our audit scope (and therefore this audit report) focused on systems and procedures used by ADEM to manage, control, and expend grant funds in accordance with applicable laws and regulations, including the Stafford Act and 44 CFR. We divide findings into two sections: Program Management and Financial Management. Our recommendations for each finding, if implemented by ADEM, would improve management, strengthen controls, or correct noncompliance.

Program Management

- ADEM's administrative plans referred to outdated legislation. Administrative plans for the HM and IFG programs referred to complying with the Single Audit Act of 1984 instead of the Single Audit Act Amendments of 1996. The amended Act revised audit-timing requirements for subgrantees and revised certain elements of how an audit is to be performed.
- ADEM did not have clear procedures to ensure that IFG program plans were submitted annually. IFG administrative plans for both disasters lacked clear procedures for updating and submitting an administrative plan to the Regional Director each January. Additionally, ADEM did not submit annual administrative plans to the Regional Director during 1999 and 2000.
- ADEM exceeded IFG program completion deadlines for grant and administrative activity. Although deadlines for both disasters were exceeded, ADEM did not request extensions.
- ADEM did not submit Section 409 HM plans for each disaster. ADEM did not submit a plan for Disaster No. 1304 to the region. It submitted a draft plan for Disaster No. 1347 on December 14, 2001, although the plan was due on April 25, 2001. ADEM has not submitted a final plan for this disaster.

- ADEM did not submit quarterly progress reports for three sampled HM projects. It did not realize that progress reports were required for management grants, and it did not submit reports for other HM projects, because it could not obtain information from subgrantees in a timely manner.
- ADEM did not obtain documentation to support the required benefit-cost analysis of a project or obtain documentation to show that a house was substantially damaged at the time of project approval. Such documentation is required to ensure that the project was eligible for funding.
- ADEM did not require buy-out project applicants to sign agreements with the Regional Director stating that restrictive covenants would be included in all buy-out deeds. Additionally, deed restrictions were not obtained for properties acquired for one project.
- ADEM did not have procedures to assure proper controls over an advance given to one HM subgrantee. ADEM did not monitor the advance to ensure that it was disbursed in a timely manner for allowable items.
- ADEM did not have documentation or internal control procedures to ensure the cost allowability of all HM subgrantee payments.

Financial Management

- ADEM did not adequately support claimed IFG administrative costs for both disasters.
- ADEM did not segregate IFG administrative and PA management grant costs. ADEM had not established a sufficient number of accounting codes to permit adequate segregation of costs.
- ADEM did not have adequate cash management procedures over IFG projects.
- ADEM did not submit quarterly Financial Cash Transaction Reports (FCTR) to FEMA.
- ADEM did not accurately report total program outlays on Financial Status Reports (FSRs). In certain cases, only the federal share of program outlays was reported.
- ADEM did not review a subgrantee's cost-share expenses throughout the HM project.

We have summarized comments from the FEMA regional office and ADEM management officials in the body of this report and included additional auditor reaction to those comments if necessary. Full comments from the FEMA regional office and ADEM are attached to this report (Attachment C). Regional office and ADEM management generally agreed with findings and recommendations.

II. INTRODUCTION

FEMA awards disaster grants in declared disaster areas. It typically awards a single grant to the state (grantee) in which a disaster occurs. Under the PA and HM grant programs, the state agency or division responsible for emergencies and mitigation awards subgrants to other state agencies, local government entities, and eligible nonprofit organizations for repairing and replacing facilities, removing debris, and establishing emergency protective measures as a result of a disaster. HM grants are awarded to states to

help reduce the potential for damages from future disasters. Under the IFG program, the state awards subgrants to individuals and families to cover disaster-related expenses they cannot meet or that are not otherwise covered.

The Stafford Act authorizes these three programs (PA, HM, and IFG). Each has separate objectives and regulations, as described in 44 CFR 206.

ADEM, the state agency (grantee) responsible for administering these programs, is part of the Department of Emergency and Military Affairs within the State of Arizona. State appropriations and FEMA Emergency Management Performance Grants fund ADEM's daily operations. Emergencies are funded through FEMA cost-shared disaster grants. The state pays its share through appropriations or, when it deems appropriate, subgrantees pay the state share. ADEM does not use the services of other state agencies. It must, however, work closely with other departments and agencies, such as the Department of Transportation, to accomplish its goals.

The Public Assistance program under Disaster No. 1347 was administered under a pilot program called "State Managed, Small Disaster". Under this program, ADEM had more responsibility for preparing project estimates, and overseeing certain aspects of this program. The Individual and Family Grant program under both disasters was also administered differently than in most states. Due to the lack of experienced staff at ADEM, FEMA's National Processing Service Center was responsible for processing the applicant files under the program. ADEM maintained the overall responsibility for internal controls and overall compliance of the grant award. This segregation of duties was documented in a Memorandum of Understanding between the two parties.

III. OBJECTIVES, SCOPE, AND METHODOLOGY

Our primary audit objective was to determine if ADEM administered FEMA disaster grant programs according to federal regulations. Specifically, we reviewed all material aspects of the grant cycle including:

- Administrative Plan
- Subgrantee Award Process
- Project Completion
- Project Closeout
- Subgrantee Monitoring
- Administrative Costs
- Cost-Share Requirements

To assess compliance and performance with grant management provisions, we selected and tested numerous PA and HM projects and IFG recipient files to determine if the project or recipient was administered within program guidelines. We included both open and closed projects or recipients in our review, but emphasized the evaluation of ADEM's current internal controls and procedures to identify current internal control system weaknesses or noncompliance issues. When developing findings and recommendations, we considered the views of the FEMA regional office and guidance from FEMA headquarters.

We also evaluated how ADEM accounted for and used FEMA program funds to ensure that ADEM had internal controls and procedures in place to account for program funds and safeguard federal assets. Finally, we reviewed ADEM's financial reporting process to ensure that it submitted accurate financial expenditure reports. These two objectives included a review of overall internal controls of ADEM,

management oversight activities, and the financial management system used by ADEM. In our sample of PA and HM projects and IFG recipients noted above, we tested expenditures incurred for allowability in accordance with applicable cost principles. We also selected several financial reports submitted by ADEM and reconciled those reports to:

- Supporting accounting system used by the State of Arizona
- ADEM's Federal Cash Transaction Reports (FCTRs)
- FEMA database (NEMIS)
- FEMA's accounting system (IFMIS)

Our review of financial reports also included reviewing ADEM's system for allocating costs to disasters and programs, testing the timeliness and accuracy of payments to subgrantees and recipients, determining the timeliness of financial reporting, and evaluating ADEM's overall cash management (both the timing of funds drawn down from the SMARTLINK system and how funds are advanced to subgrantees).

The scope of our audit consisted of the following two disasters declared between October 1999 and October 2000:

Disaster No.	Type of Disaster	Date Declared	Assistance Provided
1304	Severe Storms, Flooding, and High Winds	10/15/99	HM, IFG
1347	Severe Storms and Flooding	10/27/00	PA, HM, IFG

The audit cut-off date was September 30, 2001. ADEM made payments through the State of Arizona accounting system, and ADEM had policies and procedures for compliance with state accounting guidelines.

Our audit was conducted in accordance with the FEMA Consolidated Audit Guide for Grantee Audits of FEMA Disaster Programs provided by the Office of Inspector General (OIG). Our audit work included a site visit to the FEMA Region IX office in San Francisco, California, and audit fieldwork at ADEM's office in Phoenix, Arizona. Our methodology included reviewing files at FEMA Region IX, discussing ADEM's administration and grant oversight with Region IX personnel, and reviewing region and ADEM contract files, accounting records, and correspondence, including administrative and program plans. We also interviewed knowledgeable FEMA and ADEM personnel. Our audit scope did not include interviews with ADEM subgrantees, a technical evaluation of the work performed, or assessment of repairs of disaster-caused damages.

The State Auditors Office conducts annual audits of ADEM. In Fiscal Years 1998, 1999, and 2000, the auditors identified findings and recommendations related to the FEMA grants. We reviewed these reports and their supporting workpapers to determine if these findings affected our audit scope or specific audit tests. ADEM also has each project audited upon completion by their own auditors. We reviewed these reports and noted that the audits include a thorough review of cost allowability and include verification of all cost categories. Additionally, the FEMA OIG has conducted several audits of PA subgrantees. We reviewed the reports of these audits to determine if findings at the subgrantee level had an effect on our audit scope or procedures. Because of all the oversight regarding the cost allowability of project costs, it was agreed with FEMA OIG that our audit would not include a review of the cost allowability of the Public Assistance or Hazard Mitigation projects.

The audit was conducted in accordance with *Government Auditing Standards*, as revised, as prescribed by the Comptroller General of the United States. We were not engaged to and did not perform a financial statement audit, the objective of which would be to express an opinion on specified elements, accounts, or items. Accordingly, we do not express an opinion on costs claimed for disasters under the scope of the audit. If we had performed additional procedures or conducted an audit of the financial statements in accordance with generally accepted auditing standards, other matters might have come to our attention that would have been reported. This report relates only to accounts and items specified and does not extend to any financial statements of the State of Arizona, Department of Emergency and Military Affairs, Division of Emergency Management, or the State of Arizona.

IV. FINDINGS AND RECOMMENDATIONS

Audit results are summarized in two major sections: Program Management and Financial Management. These sections contain findings and related recommendations.

Based on the number and nature of findings, we concluded that management controls and financial management controls could be improved to better protect assets and prevent errors and fraud. Relative to the findings, we concluded that ADEM did not comply with applicable laws and regulations as follows.

A. Program Management

1. ADEM's administrative plans referred to outdated legislation.

ADEM is required to comply with the Single Audit Act Amendments of 1996, which require the grantee and subgrantees to undergo an audit in accordance with Act terms. ADEM's administrative plans for the IFG program referred to the Single Audit Act of 1984, which, in turn, required compliance with Office of Management and Budget (OMB) Circular A-128. The Single Audit Act of 1984 was replaced by the Single Audit Act Amendments of 1996, and OMB Circular A-128 was superceded by OMB Circular A-133.

Administrative plans are required under the IFG (part of the Individual Assistance Grant) program of the Stafford Act—in accordance with 44 CFR 206.131, *Individual and family grant programs*. FEMA requires administrative plans to ensure that grantees are prepared for future disasters, and that stated policies and procedures will effectively accomplish grant goals.

ADEM personnel noted that they were unaware that the plans were incorrect or that the Single Audit Act was amended in 1996. When preparing administrative plans, ADEM personnel followed information presented in the CFR, which referred to the Single Audit Act of 1984.

ADEM may fail to handle issues properly if plans are outdated or incorrect. Also, the region cannot be assured that ADEM has sufficient procedures if plans are incorrect.

Conclusions and Recommendations: We recommend that the Regional Director (RD) implement internal controls that ensure ADEM's administrative plans be kept current and refer to legislation current at the time of preparation.

State Response: “The State concurred. The Arizona Department of Emergency Management (ADEM) Hazard Mitigation (HM) and Individual and Family Grant (IFG) administrative plans for 2002 have been amended to reference the Single Audit Act Amendment of 1996 and OMB Circular A-133. ADEM’s response to the draft performance report includes excerpts from the 2002 HM and IFG administrative plans verifying that the most current documents are referenced.”

Regional Response: *“Individual and Family Grant Program:* The Response and Recovery Division (RRD) program management has instructed program specialists to check State Administrative Plans (SAP) for references to obsolete regulations and policies and instruct ADEM to update these references before plan approval. A checklist is now available for the FEMA specialist to ensure that the appropriate references are included when reviewing an administrative plan. Program management also provided IFG training and IFG handbooks to ADEM on the proper compilation of a SAP. The same tools will also be available for the new Individual and Households Program (IHP).

Hazard Mitigation Program: ADEM has amended their administrative plan for the Hazard Mitigation Grant Program (HMGP) to convey that financial audits are performed in accordance with the Single Audit Act Amendment of 1996, the most current legislation.”

Auditors’ Additional Comments: Revised administrative plans were provided to the auditors. This recommendation is considered resolved and closed.

2. ADEM did not have clear procedures to ensure that IFG program plans were submitted annually.

ADEM’s IFG administrative plans for Disaster Nos.1304 and 1347 did not clearly identify procedures for submitting a revised administrative plan each January to the Regional Director [44 CFR 206.131(e)(viii)(D)(3)]. Additionally, ADEM did not submit annual IFG administrative plans for 1999 and 2000, timely.

ADEM personnel noted that they were initially unaware of this requirement, and that the regional office did not emphasize the importance of submitting the plans. ADEM personnel also noted that they assumed that the Disaster No. 1304 plan would meet the January requirement, because it was submitted close to the required date. ADEM may fail to handle issues properly if plans are outdated, incorrect, or not submitted.

Conclusions and Recommendations: We recommend that the RD require ADEM to revise IFG administrative plans to include procedures for submitting administrative plans to the RD each January.

State Response: “The State concurred. ADEM’s IFG SAP notes the Regional Director’s yearly review in January. However, ADEM did not submit the 1999 and 2000 IFG SAPs by their January deadlines. Instead, the plans were reviewed in conjunction with declared disasters.”

Regional Response: “The new IHP requires the signed SAP be submitted prior to November 30 each year for FEMA’S review and approval by December 31, and a program specialist is assigned to that review. Generally, RRD program management has communicated this annual requirement to the Region IX state partners through training and written correspondence, and will continue to do so. ADEM formally submitted their current IHP SAP for the effective period (10/15/02 through 12/31/03) prior to the deadline. The SAP was reviewed and approved by the Regional Director.”

Auditors' Additional Comments: The actions taken by ADEM could adequately resolve this recommendation. This recommendation is resolved, however it will remain open until actions can be verified.

3. ADEM exceeded IFG program completion deadlines for grant and administrative activity.

In completing administrative activities and submitting reports and vouchers for Disaster No. 1304, the IFG program exceeded the completion deadline by 9 months. At the end of fieldwork for Disaster No. 1347, the IFG program had still not submitted the final closeout package even though 7 months had elapsed since the completion deadline. ADEM could have, but did not, request extensions for either disaster.

Initial due dates, extensions, and closeout submission information for the disasters follow:

Disaster No.	Initial Completion Due Date	Extensions Received	Actual Closeout Submission
1304	09/09/00	0	06/04/01
1347	09/22/01	0	Not submitted as of 04/19/02

DEM is required to complete all administrative activities and submit final reports and vouchers to the Regional Director within 90 days of completion of all grant award activities [44 CFR 206.131(j)(1)(iv)]. Section 206.131(j) (2) further provides that:

...the Governor's Authorized Representative may submit a request with appropriate justification for the extension of any time limitation. The Regional Director may approve the request for a period not to exceed 90 days. The Associate Director may approve any request for a further extension of time limitations.

The state's grant coordinating officer did not understand closeout requirements for Disaster No. 1304, nor realize that there were deadlines to submit the closeout package. For Disaster No. 1347, the state's grant coordinating officer did not realize that extension requests should be done in writing and submitted to the regional office because none were done for Disaster 1304. In both cases the region's human services officer did believe that formal, documented extension requests and approvals were necessary because he was aware that no awards to recipients were made after the deadline. Although regional staff may be aware of delays and causes of delays in completing administrative activities and final reports, without formal requests for extensions and justifications for those extensions, FEMA managers and directors will not know the status of IFG programs and causes for delays.

Conclusions and Recommendations: We recommend that the RD require 1) IFG program representatives submit appropriate requests for time extensions and 2) ADEM to strengthen policies and procedures to complete IFG closeout packages in a more timely manner.

State Response: "The State concurred. In their response to the audit report, they explain that the DR-1347 closeout delay was due to the late identification of a significant case (#910186614)."

Regional Response: “The DR-1347 Volunteer Agent (VOLAG) presented case #910186614 to the region as an unmet need after the projected closure date. After consultation with FEMA headquarters, the region decided that a program extension would not contribute to the efficient resolution of this case. While the region recognizes that program delivery focuses on customer service, we agree that a standard operating procedure for time extensions and stronger emphasis on timely completion and closeout of the program should be established. To ensure that states meet IFG program completion deadlines, it is standard procedure for the Virginia National Processing Service Center (VNPSC) to send written notification to the states when the IFG closure date is approaching. The notification serves as a reminder for the state to submit a program closeout package in a timely manner or request an extension if needed. In the future, the Individual Assistance program managers will ensure that program deadlines are adhered to or requests for time extensions are received, approved and processed. Failure of applicants to adhere to these regulations would result in deobligation of funding.”

Auditors’ Additional Comments: No proposed actions were identified in ADEM and Regional responses. Therefore this recommendation remains open.

4. ADEM did not submit Section 409 HM plans as required for each disaster.

ADEM did not meet submission requirements for the Section 409 HM plans as follows:

- **Disaster No. 1304.** ADEM did not submit its plan for this disaster to the region. ADEM noted that the plan was prepared and submitted to an ADEM employee for approval, but that employee never approved the plan. ADEM did not provide an explanation for lack of follow up on the status of plan approval.
- **Disaster No. 1347.** ADEM did not submit a final plan to the region. It submitted a draft plan on December 14, 2001, although the submission deadline was April 25, 2001. ADEM has not submitted a final plan, and the grantee has not requested extensions. FEMA Region IX and ADEM personnel noted that plan submission was delayed, because ADEM was waiting on the Disaster Mitigation Act of 2000 regulations to be published in the Federal Register so that it could implement the changes into the Disaster No. 1347 plan.

According to 44 CFR 206.405(d):

All States shall submit a hazard mitigation plan or plan update on behalf of the State and any appropriate local governments included in the designated area. The plan or update is due to FEMA within 180 days of the date of the declaration. The Regional Director may grant extensions to this date not to exceed 365 days from the date of the declaration when adequate justification is received in writing from the State. Extensions beyond that date must be forwarded with justification to the Associate Director for approval.

Delays in submitting and approving plans may cause delays in receiving and awarding projects. Additionally, the region may be unaware of project timing and upcoming funding requirements.

Conclusions and Recommendations: We recommend that the RD require ADEM to implement procedures to ensure that it prepares Section 409 plans, submits them to the region in a timely manner, and maintains documentation to support plan submission.

State Response: “The State concurred. ADEM Hazard Mitigation staff wrote and submitted a draft disaster DR-1304 Section 409 HM plan to ADEM management for recommendations and approval. ADEM, however, never approved the draft plan for submittal to FEMA. In Disaster DR-1347, ADEM asked Region IX to extend the deadline for submitting the HM plan until approval of the Disaster Mitigation Act 2000 regulations. ADEM could then write the plan to include the new regulations. FEMA extended the deadline.”

Regional Response: “The State submitted a draft HM SAP to FEMA on December 14, 2001. Pursuant to 44 CFR Part 206.430(g), *Section 409 Hazard Mitigation Plan*, the plan is required as a condition of receiving federal disaster assistance under Public Law 93-288, as amended. This regulation does not stipulate *when* the plan must be approved as a condition of receiving federal assistance, only that it is required as a condition of receiving federal assistance.

Regional HM Management wrote a letter, dated January 28, 2002, to Michael Austin, then ADEM Director, commenting on ADEM’s draft SAP as submitted in December 2001. The HM management recognized ADEM’s intention to incorporate Disaster Mitigation Act 2000, Section 322 planning criteria into their final HM SAP and although they did not approve the draft plan, they offered guidance and technical assistance.

Pursuant to 44 CFR part 206.437(d), *Approval*, funds shall not be awarded until the SAP is approved by the FEMA Regional Director. The SAP was approved by FEMA on November 7, 2000, prior to the award of hazard mitigation funds.”

Auditors’ Additional Comments: The Region’s response addresses the SAP (State Administrative Plan), while the finding recommendation is in regards to a Section 409 Mitigation Plan. However ADEM’s response noted that they have submitted the Section 409 plan to the Region. This recommendation remains open until new policies and procedures can be verified.

5. ADEM did not submit required quarterly progress reports for three sampled HM projects.

ADEM did not have adequate procedures in place to ensure that progress reports were completed and did not document when reports were submitted. Of the five projects sampled for Disaster Nos. 1304 and 1347, including one management grant, ADEM did not submit required progress reports for three, as follows:

Project	Disaster No.	Project Approval Date	Report Date	Date Report Received by Region
Graham County	1304	04/28/00	06/18/01	06/18/01
Yavapai County	1347	01/24/01	05/22/01	12/12/01
			07/01/01	10/30/01
Management Grant	1347	11/07/00	02/08/02	02/08/02

The grantee is required to submit a quarterly progress report to FEMA indicating the status and completion date for each project funded [44 CFR 206.438 (c)].

ADEM did not submit progress reports for the Disaster No.1347 management grant, because it did not realize that progress reports were required. ADEM submitted the first progress report for this management grant in February 2002 after being advised by the region that the report was required.

ADEM noted that the adequate progress reports were not prepared for the other projects, because it could not obtain information from subgrantees in a timely manner. Because ADEM did not realize the importance of documenting the submission of progress reports, it did not keep transmittal letters, emails, or fax sheets to support report submission.

Conclusions and Recommendations: We recommend that the RD ensure that ADEM strengthen policies and procedures surrounding both the timely submittal of quarterly progress reports for all projects and maintaining documentation to support report submission.

State Response: “The State concurred. ADEM has taken the corrective action described in the regional response.”

Regional Response: “ADEM has instituted a system that notifies subgrantees by email 15 days before quarterly reports are due. ADEM will enter quarterly progress reports directly into NEMIS. ADEM will notify the region that the reports have been entered into NEMIS via the Strategic Plan Report due each quarter to the region. The HMGP specialist will also monitor the submission of quarterly progress reports through NEMIS.”

Auditors’ Additional Comments: The actions taken by ADEM could adequately resolve this recommendation. This recommendation is resolved, however it will remain open until actions can be verified.

6. ADEM did not obtain documentation to support the required benefit-cost analysis of a project or obtain documentation to show that a house was substantially damaged at the time of project approval.

ADEM did not include the required benefit-cost analysis in the project application for one of four non-management grant projects sampled. Additionally, ADEM did not include any documentation in the project application of this buy-out project that indicated that the project was substantially damaged at the time of project approval.

To be eligible for the HM program, a project must be cost effective and substantially reduce the risk of future damage, hardship, loss, or suffering resulting from a major disaster [44 CFR 206.434 (5)]. The project also must demonstrate this by documenting that it will not cost more than the anticipated value of the reduction in both direct damages and subsequent negative impacts to the area if future disasters were to occur. Costs and benefits are to be computed on a net present value basis [44 CFR 206.434 (5)(ii)]. A September 1996 memorandum from FEMA headquarters to the Regional Directors provided additional guidance on this subject. It stated that a benefit-cost analysis is not required if the project has a structure designated as substantially damaged (or uninhabitable) by the county.

ADEM and regional personnel assumed that the houses for this project were designated as substantially damaged, but it did not obtain certifications to support this. Local officials were reluctant to declare homes as substantially damaged, because the residents might have incurred financial hardships if the project application was not approved or if residents decided to not participate in the program. Flood Plain Regulations require that once a home is designated as substantially damaged, the home must be repaired, or the residents must move from the home.

The project was not eligible at the time of project funding, because a benefit-cost analysis had not been performed and a substantially damaged certification had not been obtained. During our audit, a certification was obtained from the county.

Conclusions and Recommendations: We recommend that the RD require ADEM to strengthen policies and procedures to ensure that a benefit-cost analysis is performed or a substantially damaged certification is obtained before project approval, and monitor HM projects to ensure the documentation is maintained in the project file.

State Response: “The State concurred. Beginning with FEMA Disaster DR-1422-AZ, ADEM will not submit HMGP acquisition applications to FEMA unless they contain the minimum information required for a Benefit-Cost Analysis (BCA) or a certification of substantial damage. If a local jurisdiction refuses to declare a structure as substantially damaged, then a BCA must be done on the structure. ADEM will be responsible for gathering all information necessary for the region to conduct a BCA. All documentation supporting the BCA or a copy of the county’s substantially damaged determination will be maintained in individual project files.”

Regional Response: “The region has now required ADEM to strengthen policies and procedures to ensure that a BCA is performed or a substantially damaged certification is obtained before project approval. ADEM will monitor HM projects to ensure maintained documentation is in the project file.”

Auditors’ Additional Comments: The actions taken by ADEM could adequately resolve this recommendation. This recommendation is resolved, however it will remain open until actions can be verified.

7. ADEM did not require buy-out project applicants to sign agreements with the Regional Director stating that restrictive covenants will be included in all buy-out deeds.

ADEM did not require acquisition project applicants to enter into signed agreements with the Regional Director stating that certain restrictive covenants would be included in the deeds of all properties acquired. Additionally, deed restrictions were not obtained for properties acquired for project 1347-3.

According to 44 CFR 206.434(d),

A project involving property acquisition or the relocation of structures and individuals is eligible for assistance only if the applicant enters an agreement with the FEMA Regional Director that provides assurances that: (1) The following restrictive covenants shall be conveyed in the deed to any property acquired, accepted, or from which structures are removed...

ADEM did not have procedures to ensure that deed restrictions were obtained. Additionally, ADEM noted that it was unaware of the CFR requirement to obtain a signed agreement between an applicant and the Regional Director.

If restrictive covenants are not properly included in the deeds of purchased properties, the properties may be sold and used for unauthorized purposes. Without the signed agreement, the Regional Director does not have assurance that required restrictions will be included on the deeds. Deeds for this project were transferred without the required restriction.

Conclusions and Recommendations: We recommend that the RD require ADEM to implement procedures to ensure that a restrictive covenants agreement is signed before approval and acquisition of any properties.

State Response: “The State concurred. The State, however, maintains that the HMGP application that was signed by the applicant stipulates that the subgrantee (applicant) will maintain land as open space. To illustrate, the State in their audit response attached a “Terms of Use” approved by the La Paz County Board of Supervisors on November 4, 2002. This regulation required restrictive covenants in all acquired properties. The State has agreed that all future HM acquisition projects will require restrictive covenants placed on deeds.”

Regional Response: “Beginning with the current declared disaster, DR-1422-AZ, FEMA will require applicants to enter into an agreement with the FEMA Regional Director that provides for the assurances as required by 44 CFR 206.434 (d).”

Auditors’ Additional Comments: The actions taken by ADEM could adequately resolve this recommendation. This recommendation is resolved, however it will remain open until actions can be verified.

8. ADEM did not have procedures to assure proper controls over an advance given to one HM subgrantee.

One HM subgrantee received an advance for a project funded by Disaster No. 1347 grant funds. ADEM was, however, unable to provide documentation to show when the subgrantee expended this advance.

According to 44 CFR 13.21 (c),

Grantees and subgrantees shall be paid in advance, provided they maintain or demonstrate the willingness and ability to maintain procedures to minimize the time elapsing between the transfer of the funds and their disbursement by the grantee or subgrantee.

ADEM did not realize requirements for advances of federal funds to subgrantees. Therefore, it did not monitor the advance to ensure that it was disbursed in a timely manner for allowable items. Additionally, ADEM did not assure that the subgrantee had an adequate financial management system in place to maintain controls over advances of federal funds.

Advances pose an increased risk for federal funds. Without adequate monitoring procedures for advances, ADEM is unable to ensure that a subgrantee spends an advance in a timely manner on allowable items. If funds were not spent for allowable items, the grantee would be required to attempt recovery of funds from the subgrantee.

Conclusions and Recommendations: We recommend that the RD require ADEM to implement procedures over advances given to subgrantees to ensure that advances are spent on allowable items in a timely manner.

State Response: “The State concurred. ADEM will amend the administrative plan to include procedures for control of advances given to HM subgrantees. A copy of the page of the amended administrative plan for advances is included with the ADEM response package.”

Regional Response: “ADEM has adequately amended their administrative plan to assure proper controls over advances given to subgrantees.”

Auditors’ Additional Comments: Revised administrative plans with amended procedures were provided to the auditors. This recommendation is considered resolved and closed.

9. ADEM did not have documentation or internal control procedures to ensure the cost allowability of all HM subgrantee payments.

ADEM did not have documentation or internal control procedures to ensure the cost allowability of all HM payments to subgrantees, as follows:

- **Project 1304-1.** This project under this disaster used in-kind labor and mileage to satisfy its cost-share requirements. The file for this project did not, however, contain support for the in-kind amount, and ADEM could not provide such support during our testing. ADEM was not aware of the complex regulations regarding documentation required for in-kind support.

ADEM could not support claimed in-kind costs of \$1,814 with adequate supporting documentation. Therefore, total eligible project costs (Federal share and matching requirements) are reduced by \$1,814. If total project costs are reduced by \$1,814, then the eligible Federal share is reduced by \$1,361 (or 75% of \$1,814). We will question \$1,361 representing the federal share of ineligible project costs.

- **Project 1347-2.** This project received an advance, but the project file did not contain documentation to show how costs were spent. The subgrantee has certified that the project is complete (and that all costs have been incurred), and the grantee has requested that the project be audited by the ADEM auditors, however the grantee did not request supporting documentation for how the advance was spent throughout the life of the project. ADEM personnel noted that they did not realize that support for actual costs incurred was required for advances, because they assumed that internal auditors were responsible for obtaining invoices for all costs incurred. We questioned \$24,020 of currently unsupported project costs.

44 CFR 13.20 (5) states that applicable OMB cost principles, agency program regulations, and terms of grant and subgrant agreements will be followed in determining the reasonableness, allowability, and allocability of costs.

Conclusions and Recommendations: We recommend that the RD ensure that ADEM 1) implements policies and procedures to review the cost allowability of all project costs, those federally funded and funded through cost share; 2) implement additional controls when advances are given to subgrantees, to require the subgrantees to support how advances were spent, and to support that advances were spent timely. Additionally, we recommend that ADEM reimburse FEMA for \$25,381 of questioned project costs.

State Response: “The State concurred. ADEM’s audit response package states “[For] Project 1304-1, ADEM will assist Graham County in compiling documentation to support the \$1,814 in-kind costs. If it appears that the documentation cannot be found, ADEM will seek reimbursement of the \$5,442 federally funded project costs.”

In regards to Project 1347-2, ADEM submitted the project with supporting documentation for a state audit in November of 2001. The completed audit is still forthcoming.

ADEM also asserts “in the future, all request for advances will be made in writing to the Governor’s Authorized Representative (GAR). All request must be accompanied by a contract, purchase requisition, or unpaid invoice. Subgrantees receiving approval by the GAR for an advance must submit documentation that the advance was expended within 3 days of their receiving the grant (HM administrative plan has been edited to reflect this change).” ADEM attached page 7 of their 2002 HM SAP, entitled “Advance or Partial Reimbursements”.”

Regional Response: “In reference to Project 1304-1, ADEM told FEMA on February 14, 2003 that they would resolve any questions on ineligible project cost by March 26, 2003. ADEM plans on meeting with the subgrantee to collect the supporting documentation. ADEM will reimburse FEMA for any costs that cannot be supported. The region accepts this time frame for resolving cost eligibility.

In reference to Project 1347-2, ADEM told FEMA on February 14, 2003 that the State audit of the project is nearly complete. The State auditor has tentatively indicated that there are no unsupported project costs. The region will continue to monitor the State audit process and request a final determination.”

Auditors’ Additional Comments: The actions taken by ADEM could adequately resolve this recommendation. This recommendation is resolved, however it will remain open until actions can be verified.

B. Financial Management

10. ADEM did not adequately support claimed IFG administrative costs.

FEMA awards administrative costs to grantees to help offset the costs of administering a disaster. FEMA personnel at the National Processing Service Center (NPSC) in Virginia administered many functions for the IFG programs for both disasters. ADEM was responsible for overall project compliance, including supervising FEMA personnel processing applicant cases and ensuring that the project complied with the state administrative plan. Because of this unique situation, FEMA did not initially award administrative funds to ADEM. FEMA subsequently awarded ADEM administrative costs once it determined that administrative costs were still required for program supervision. We noted instances in which support for administrative costs for both disasters was inadequate.

- **Disaster No. 1304.** ADEM claimed labor and travel costs, but was unable to provide adequate support. Specifically, it could not provide timesheets for the claimed period as evidence that an individual was working on this disaster. ADEM also could not provide invoices or receipts to note the type of travel costs incurred. We questioned \$3,723 of administrative costs claimed from Disaster No. 1304
- **Disaster No. 1347.** ADEM claimed labor, fringe benefits and related indirect costs. Labor and related fringe benefit costs are not adequately supported because timesheets used by ADEM personnel did not indicate the types and number of labor activities performed. Goods or services chargeable or assignable to a cost objective must be commensurate with relative benefits received (44 CFR 13.22 and OMB Circular A-87). Additionally, all personnel administering the IFG, HM, and PA programs charged their labor activities to the same accounting code. It is very difficult to determine costs

associated with each program. Indirect costs claimed were supported by an appropriate indirect cost rate agreement with the Department of Health and Human Services, but the rate is applied to unallowable labor and related employee benefit costs as noted above. We questioned \$26,861 of administrative costs claimed from Disaster No. 1347.

Conclusions and Recommendations: We recommend that the RD require ADEM to 1) support all claimed costs with adequate supporting documentation 2) revise its timekeeping procedures to identify labor hours by program, and note all hours worked; and 3) use separate accounting codes for each program and disaster.

State Response: “The State does not concur. For Disaster 1304 and 1347, ADEM has supplied supporting documentation for disaster related personnel salaries. ADEM has not yet received the questioned amount of \$26,861 in administrative costs.”

Regional Response: “Upon receipt of the closeout package, the regional program specialist worked closely with ADEM to provide appropriate justification and documentation for State incurred administrative costs. The State lacked proper documentation when the original IFG closeout package was received in the region. The region will require ADEM to incorporate into their SAP the following items: a description of the supporting documentation needed to support all claimed costs, revised timekeeping procedures to identify labor hours by program, and procedures to ensure all hours worked are captured and implement use of separate accounting codes for each program and each disaster. The regional program specialist continues to work with ADEM to ensure that the IFG closeout is correct and appropriate, which includes a thorough review of the administrative costs. The region will evaluate ADEM’s supporting documentation in order to support project cost claims of \$3,723 and \$26,861 respectively. Under IHP, the State of Arizona has chosen the option in which FEMA administers and processes the Other Needs Assistance (ONA), which replaces IFG. This means that ADEM will not be eligible to claim administrative costs for the disasters declared between 10/15/02 through 12/31/03. There will be no need to support ONA administrative costs for purposes of Federal reimbursement.”

Auditors’ Additional Comments: The actions taken by ADEM could adequately resolve this recommendation. While the administrative costs for Disaster No. 1347 were not drawn down from SMARTLINK at the time of our audit, ADEM has drawn down funds in excess of total program expenses as discussed in Finding No. 12. Therefore, while the administrative funds have not yet been drawn, ADEM will need to issue a refund to FEMA for either the full amount of the overdrawn funds, or less depending on if any questioned costs here can be supported.

11. ADEM did not segregate IFG administrative and PA management grant costs.

ADEM uses the statewide accounting system to prepare FSRs; it must, however, review certain accounting codes at the transaction level to identify costs associated with the PA and IFG programs. Additionally, costs may be originally charged to state-funded codes. When funds are later federally funded, journal entries move costs to other codes, but journal entries do not move individual transactions of several transactions, only the subtotals. It becomes increasingly difficult to identify transactions reimbursed by federal funding using these procedures.

ADEM representatives noted that only a few codes were established at the start of the disaster, and they were unaware that having separate codes would be useful. ADEM noted that it would establish separate codes in the future.

Conclusions and Recommendations: We recommend that the RD require ADEM to establish separate codes for each disaster and program and separate codes to segregate subgrantee or recipient payments from administrative costs.

State Response: “The State concurred. ADEM, however, stated that transaction item accounting would increase their costs and expressed concern over the proposed rule that would limit administrative costs to 4.41%. ADEM has established separate accounting cost codes for the latest disaster, DR-1422, for each program and its sub-elements.”

Regional Response: “The region will require ADEM in the future to break up subtotals in journal entries by program, if they obscure the funding source and make it difficult to separate out PA and IFG administrative costs from each other and other subgrantee recipient costs. This requirement will be incorporated into the SAP. Again, under IHP, the State of Arizona has chosen the option in which FEMA administers and processes the Other Needs Assistance (ONA), which replaces IFG. This means that ADEM will not be eligible to claim administrative costs for the disasters declared between 10/15/02 through 12/31/03. There will be no need to support ONA administrative costs for purposes of Federal reimbursement.”

Auditors' Additional Comments: The actions taken by ADEM could adequately resolve this recommendation. This recommendation is resolved, however it will remain open until actions can be verified.

12. ADEM did not have adequate cash management procedures over IFG projects.

Since August 2001, cumulative drawdowns for the IFG program have exceeded \$23,000 and been as high as \$24,422. According to 44 CFR 13.21 (c):

Grantees and subgrantees shall be paid in advance, provided they maintain or demonstrate the willingness and ability to maintain procedures to minimize the time elapsed between the transfer of funds and their disbursement by the grantee or subgrantee.

Several checks written to recipients were not cashed in a timely manner, and in accordance with State policy, those checks are void. As the checks are voided by the state, credits are applied to the same account that the expense was charged to, thereby reducing total eligible program costs. While ADEM is tracking these credits, and notes a reduction in total program costs, excess federal draws created by these credits were not returned to FEMA.

Conclusions and Recommendations: We recommend that the RD ensure that ADEM implement additional cash monitoring procedures over federal advances to ensure that excess advances are promptly returned. Additionally, we recommend that excess federal funds be returned to FEMA.

State Response: “The State concurred, ADEM responded by stating that the program manager was not made aware that warrants had expired on DR-1347. ADEM finance will notify program managers on a monthly basis if warrants have expired for their programs.”

Regional Response: “Grant management and related financial transactions of the Human Services Program, including IFG, are processed at FEMA headquarters. Therefore, the regional grant management specialist and the IFG program manager both have to coordinate with headquarters staff in obtaining copies of all financial documents and reports.

The region provided the ADEM finance department updates on financial matters such as expired warrants, status of cash on hand and guidance on cash management. In addition, a quarterly reconciliation of all financial activities related to the program and the updating of the tracking log are tools readily available to ADEM finance to assist them in open grant monitoring.

The regional program management has suggested that ADEM program managers coordinate with ADEM finance. The region is currently working with ADEM finance focusing on cash monitoring and collection procedures enabling the prompt return of excess federal advances. The region is also working with ADEM finance to determine if excess federal funds have not yet been retuned to FEMA and if so, initiate appropriate action. This is currently the case with the IFG final review and closeout for DR-1347, which will be completed by April 1, 2003.”

Auditors’ Additional Comments: The actions taken by ADEM could adequately resolve this recommendation. This recommendation is resolved, however it will remain open until actions can be verified.

13. ADEM did not submit FCTRs to FEMA.

FEMA uses FCTRs submitted by grantees to monitor cash advances and obtain disbursement information for each grant. ADEM believed that FCTRs only had to be submitted to the Department of Health and Human Services; therefore, ADEM did not submit FCTRs to FEMA. Grantees are required to submit FCTRs no later than 15 working days following the end of each quarter [44 CFR 13.41(c)(4)].

Without FCTRs, the region cannot perform cash management monitoring functions.

Conclusions and Recommendations: We recommend that the RD require ADEM to implement policies and procedures to ensure that FCTRs are submitted to FEMA within 15 working days after the end of each quarter.

State Response: “The State does not concur. ADEM states they are required to, and do, submit Financial Cash Transaction Reports (FCTR) to the Department of Health and Human Services (HHS) on a quarterly basis. The reports, however, are required by HHS 45 calendar days after each quarter. ADEM asserts that FEMA contracted with HHS for the smartlink and financial reporting service, which does not comply with 44CFR. ADEM states they did submit copies of these reports to FEMA. ADEM further says that FEMA wanted both the completed reports and copies of the information screens. ADEM has provided these.”

Regional Response: “While we acknowledge ADEM has not been following 44 CFR 13.31 (4) which requires submission of FCTR to FEMA within 30 working days after the reporting period, they have in fact submitted all their quarterly reports. As an example, with the exception of Quarter Period January 1st to March 31st, which was received on time, the FCTR for fiscal year 2002 received from ADEM were between 15-25 days late.”

Auditors' Additional Comments: At the time of our review, the Grants Management Specialist noted that FCTRs had not been received. FCTRs may have been received subsequent to the date of our audit, however there were no proposed policies or procedures in the responses provided, therefore the recommendation remains open.

14. ADEM did not accurately report total program outlays on FSRs.

ADEM submitted FSRs that inaccurately reported program outlays, as follows:

Local Match: Total program outlays were understated, because the 10% local cost-share match for PA projects and 25% local cost-share match for HM projects were not reported on the FSRs. ADEM used information from the state accounting system to prepare FSRs; the accounting system did not, however, include the local cost-share match. ADEM personnel noted that when the project received an audit, the local share historically would be identified and manually added to the FSR. If the project was not audited (or while a project was in process), the local share is not reported on the FSR. We also noted the following:

- ADEM did not have a system in place to assure that it would receive all audit reports. Due to staffing changes at ADEM, a revised process to obtain this information will need to be developed. Many PA projects have been completed and audited; the local cost-share amount for these projects had not, however, been reported on the FSR.
- Not all PA or HM projects may be audited. Small projects under \$10,000 may be excluded from the audits. Additionally, any project 100% federally funded may be excluded from state audits.
- ADEM does not have a revised system in place to accumulate local cost-share information and to manually add the information to the accounting system.

Unclaimed Federal Expenses: Costs for PA management grants were booked to state funds and reported as the recipient share of outlays until the management grant claim was prepared, approved, and drawn down. When expenses were claimed and drawn down, ADEM would then move expenses from the recipient share to the federal share on the FSR.

44 CFR 13.41 (b) requires grantees to submit FSRs to FEMA. According to 44 CFR 13.20 (b)(1):

Accurate, current, and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant....

Without accurate financial reporting, FEMA is unable to adequately monitor grant activities.

Conclusions and Recommendations: We recommend that the RD require ADEM to either accumulate total program outlays or note on the FSR that the recipient share of amounts reported does not include the local cost-share match met by subgrantees. We also recommend that if federal expenses are incurred, they be reported as federal outlays, not as the recipient share, regardless of whether federal funds have been drawn down.

State Response: “The State concurred. ADEM will note on the Financial Status Reports (FSRs) that local cost shares by the subgrantee are not reported on the FSR.”

Regional Response: “The FSR is used by FEMA to perform the cost share analysis. The region will work with ADEM to ensure that the FSRs include a note that the recipient share of amounts reported does not include the local cost-share match met by subgrantees. The region will advise ADEM that if federal expenses are incurred they are to be reported as federal outlays, not as the recipient share, regardless of whether federal funds have been drawn down.”

Auditors’ Additional Comments: The actions taken by ADEM could adequately resolve this recommendation. This recommendation is resolved, however it will remain open until actions can be verified.

15. ADEM did not review a subgrantee's cost-share expenses throughout the HM project.

ADEM did not review a subgrantee's cost-share portion throughout the project. It did not obtain information on expenditures incurred to meet the applicant's cost-sharing requirements; it only required supporting documentation for costs reimbursed by the state (and therefore federally funded). Because ADEM did not perform this monitoring function, it was unaware of total costs incurred.

Matching costs must meet the same eligibility requirements as federally funded costs, and matching or cost-sharing costs must be “allowable costs incurred by the subgrantee” (44 CFR 13.24). The state, as a grantee to which funds are awarded, must be accountable for the use of those funds [44 CFR 206.433 (a)].

ADEM did not realize that cost-sharing expenditures must also be reviewed for allowability. ADEM could potentially overfund projects with federal funds and would not be able to determine this until the project has been completed and submitted for final audit, thus making recovery of overfunded amounts more difficult.

Conclusions and Recommendations: We recommend that the RD ensure that ADEM monitor subgrantees to make sure they contribute allowable cost-share amounts throughout the course of a project.

State Response: “The State concurred. ADEM has amended the HM administrative plan to include procedures that will track a subgrantee's cost-share portion of a project.”

Regional Response: “FEMA will accept the amended HM administrative plan, which includes procedures for reviewing both the federal and non-federal share of an HMGP project.”

Auditors’ Additional Comments: Revised administrative plans with amended procedures were provided to the auditors. This recommendation is considered resolved and closed.

ATTACHMENT A

**INDEPENDENT ACCOUNTANTS' REPORT ON
APPLICATION OF AGREED-UPON PROCEDURES
STATE OF ARIZONA
DEPARTMENT OF EMERGENCY AND MILITARY AFFAIRS
DIVISION OF EMERGENCY MANAGEMENT
SCHEDULES OF SOURCES AND APPLICATIONS OF FUNDS**

April 19, 2003

Federal Emergency Management Agency
Office of Inspector General
Washington, DC

Cotton & Company LLP performed agreed-upon procedures related to the Sources and Applications of Funds Schedules for Disaster Nos. 1304 and 1347 as of September 30, 2001, prepared by the State of Arizona, Department of Emergency and Military Affairs, Division of Emergency Management (ADEM); refer to Attachments A-1 and A-2. These schedules were prepared on the cash basis of accounting. We have performed the procedures below, which were agreed to by the Federal Emergency Management Agency (FEMA), solely to assist FEMA with information needed to review those disasters. This engagement to apply agreed-upon procedures was performed in accordance with standards established by the American Institute of Certified Public Accountants. The sufficiency of the procedures is solely the responsibility of FEMA. Consequently, we make no representation regarding the sufficiency of procedures described below either for the purpose for which this report has been requested or for any other purpose. Procedures performed on each schedule were as follows:

- Verified the mathematical accuracy of the schedules.
- Verified that the amount reported as Sources of Funds for each program ties to the amount reported in SMARTLINK (FCTR) as the cumulative amount drawn down as of September 30, 2001.
- Verified that the total Applications of Funds for each program ties to the amount of cumulative expenditures reported in ADEM's quarterly Financial Status Reports (FSRs) for September 30, 2001.
- Verified that amounts reported as subgrantee and subrecipient expenses, administrative allowance, and management grant expenses tie to amounts reported in ADEM's financial management system.
- Verified that amounts reported as subgrantee and subrecipient expenses, administrative allowance, and management grant amounts do not exceed amounts awarded by FEMA in the grant award documents.
- Selected a sample of three quarterly FSRs and traced the cumulative expenditure amount to financial management system records for that period.

RESULTS

The results of our procedures are as follows:

- Attachments A-1 and A-2 are mathematically accurate.
- Amounts reported as of Sources of Funds, Federal Share, for each program tie to the amount reported in SMARTLINK as the amount drawn down as of September 30, 2001.
- Amounts reported as total Applications of Funds for each program tie to the amount of cumulative expenditures reported in ADEM's FSR for September 30, 2001.
- Amounts reported as subgrantee and subrecipient expenses, administrative allowance, and management grant expenses tie to amounts reported in ADEM's financial management system.
- Amounts reported as subgrantee and subrecipient expenses, administrative allowance, and management grant expenses do not exceed amounts awarded by FEMA in the grant award documents.
- Amounts reported as cumulative quarterly expenditures for sampled quarters tied to cumulative amounts reported in the financial management system for that period.

We were not engaged to and did not perform an audit of the Sources and Applications of Funds Schedules. The objective of an audit would be an expression of an opinion on the specified elements, accounts, or items. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the use of FEMA in evaluating the reasonableness of reported costs and should not be used by those who have not agreed to the procedures and taken responsibility for the sufficiency of the procedures for their purposes.

Very truly yours,

COTTON & COMPANY LLP

By: _____
Sam Hadley, CPA, CGFM

ATTACHMENT A-1

SOURCES AND APPLICATIONS OF FUNDS UNDER DISASTER NO. 1304
AS OF SEPTEMBER 30, 2001
(See Accompanying Agreed-Upon Procedures Report)

Description	Funds Awarded	Sources of Funds	Applications of Funds
Hazard Mitigation			
Federal Share	\$12,854	\$ 10,956	
State Share		<u>3,409</u>	
Total		<u>\$ 14,365</u>	
Program Outlays, Including Subgrantee			
Administrative Allowance			\$ 13,991
Grantee Administrative Allowance			<u>374</u>
Total Applications of Funds			<u>\$ 14,365</u>
Individual and Family Grant			
Federal Share	\$78,196	\$ 78,196	
State Share		<u>24,824</u>	
Total		<u>\$103,020</u>	
Program Outlays			\$ 99,297
Administrative Costs			<u>3,723</u>
Total Applications of Funds			<u>\$103,020</u>

ATTACHMENT A-2

SOURCES AND APPLICATIONS OF FUNDS UNDER DISASTER NO. 1347
AS OF SEPTEMBER 30, 2001
(See Accompanying Agreed-Upon Procedures Report)

Description	Funds Awarded	Sources of Funds	Applications of Funds
Hazard Mitigation			
Federal Share	\$1,293,887	\$ 146,754	
State Share ¹		0	
Total		<u>\$ 146,754</u>	
Program Outlays, Including Subgrantee			
Administrative Allowance			\$ 122,948
Grantee Administrative Allowance			4,844
Management Grants			<u>17,300</u>
Total Applications of Funds			<u>\$ 145,092</u>
Public Assistance			
Federal Share	\$4,971,251	\$2,931,739	
State Share ²		<u>863,400</u>	
Total Sources of Funds		<u>\$3,795,139</u>	
Program Outlays, Including Subgrantee			
Administrative Allowance			\$3,381,286
Grantee Administrative Allowance			74,582
Management Grants			<u>145,558</u>
Total			<u>\$3,791,393</u>
Individual and Family Grant			
Federal Share	\$ 575,000	\$ 543,242	
State Share		<u>177,031</u>	
Total		<u>\$ 720,273</u>	
Program Outlays			\$ 684,810
Administrative Costs			<u>0</u>
Total Applications of Funds			<u>\$ 684,810</u>

¹ As noted on page 5, ADEM has not incurred state costs under this project and has paid out all disbursements with state funds.

² This amount does not include cost share required by the subgrantees (10%), which is incurred at the subgrantee level and not accumulated in the state accounting system.

ATTACHMENT B

**STATE OF ARIZONA,
DEPARTMENT OF EMERGENCY AND MILITARY AFFAIRS,
DIVISION OF EMERGENCY MANAGEMENT
SCHEDULE OF QUESTIONED COSTS UNDER
DISASTER NOS. 1304 AND 1347**

Disaster No.	Program	Reason for Questioned Costs	Questioned Costs
1304	IFG	ADEM claimed unsupported IFG administrative costs, page 11.	\$ 3,723
1347	IFG	ADEM claimed unsupported IFG administrative costs, page 11.	26,861
1304	HM	ADEM did not have documentation to ensure the cost allowability of subgrantee payments, page 10.	1,361
1347	HM	ADEM did not have documentation to ensure the allowability of subgrantee payments, page 10.	<u>24,020</u>
Total Questioned Costs			<u>\$55,965</u>

ATTACHMENT C

**COMBINED COMMENTS FROM STATE OF ARIZONA,
DEPARTMENT OF EMGERCNY AND MILITARY AFFAIRS,
DIVISION OF EMERGENCY MANAGEMENT
AND FEMA REGIONAL OFFICE**